

ST 00-0008-GIL 01/25/2000 CONSTRUCTION CONTRACTORS

Construction contractors that make improvements to real estate by taking materials off the market and permanently affixing them to real estate owe Use Tax on the cost price of those materials. See 86 Ill. Adm. Code 130.2075. (This is a GIL).

January 25, 2000

Dear Xxxx:

This letter is in response to your letter dated December 10, 1999. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

We operate all throughout the United States and have tax obligations in numerous states. To facilitate these obligations, we are developing an internal database that lists the requirements of each state. We previously contacted you to develop a clearer understanding of our responsibilities and would like your written confirmation that we have documented this appropriately.

We are a manufacturer who produces the plastic material used to construct vehicle wash buildings. Vehicle wash buildings are simply the housing you see around many convenience store and stand-alone car washes. Our primary office is in STATE and we have no locations or otherwise nexus in your state. There are several ways that a sale might occur including:

Scenario 1: An end-user may purchase materials only which are shipped via common carrier.

Scenario 2: An end-user may purchase the materials and have us hire, manage and bill out for the independent contractors who perform the installation.

Scenario 3: An end-user may purchase the materials and have us train him/her on proper installation procedures.

I have summarized our understanding of our responsibilities in your state below. Please verify this information, list any changes that may be required in the space provided, sign and return to us at your earliest possible opportunity.

We understand that Illinois has a 6.25% rate for all out-of-state materials deliveries with no applicable county or city taxes. In the case that we have an exclusive material-sale as presented in scenario #1 above, we are required to collect and remit sales tax based

on retail selling price. Training and installation as well as other services are exempt as long as stated separately (itemized) per invoicing. Shipping is exempt as long as invoiced at true and actual cost with no markup or markdown and is taxable if billed out at other than true and actual cost. Under the circumstances that we encounter a dual job (installation and materials/shipping), we are considered contractors and subject to use tax based on the fabricated cost of the materials sold in which case we are permitted to bill lump sum as long as we maintain the appropriate backup documentation. We understand that we are required to file the ST-103 monthly which is due on the 20th day following the taxable period and must file zero returns even if we have no business activity in Illinois for a period. Are required to obtain a contractors' license over and above what we already have? If so, would you please send us the necessary forms. Are sales and use tax filed on separate forms in your state? Under the contractor scenario, we are subject to use tax as opposed to sales tax. Does this require another taxpayer number? If so, will we have to file two separate returns for sales or use or do all taxes appear per the same periodic filing?

We are unable to respond to your letter in the requested format. We have provided below some general principals of Illinois sales tax law that should assist you in determining if your understanding is correct. Please note that the Department of Revenue cannot provide you with any information as to any contractors' license that may be required to engage in that specific type of business in this State. We recommend that you contact the Illinois Attorney General's Office for assistance regarding that issue.

NEXUS

The following information outlines the principles of nexus. We hope it is helpful to you in determining whether your company is responsible to pay tax in Illinois.

An "Illinois Retailer" is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailer is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers. Local taxes may apply. For a list of the current tax rates including local sales taxes that are collected by the Illinois Department of Revenue, please see the Department's Sales Tax Rate Reference Manual that is located on the Department's Web site at www.revenue.state.il.us under the heading, "Tax Information - Sales and Related Taxes and Credits." If your company does not accept purchase orders in Illinois or maintain an inventory in Illinois and fill Illinois orders from that inventory, your company is not an Illinois retailer.

Another type of retailer is the retailer maintaining a place of business in Illinois. The definition of a "retailer maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201(i), enclosed. This type of retailer is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801, enclosed. The retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability. Determining whether a retailer is maintaining a place of business in Illinois

is extremely fact specific. The Department cannot make such a complex ruling with the type of limited information that is provided in requests for General Information Letters or Private Letter Rulings.

The United States Supreme Court in *Quill Corp. v. North Dakota*, 112 S.Ct 1904 (1992), set forth the current guidelines for determining what nexus requirements must be met before a person is properly subject to a state's tax laws. The Supreme Court has set out a 2-prong test for nexus. The first prong is whether the Due Process Cause is satisfied. Due process will be satisfied if the person or entity purposely avails itself or himself of the benefits of an economic market in a forum state. *Quill* at 1910.

The second prong of the Supreme Court's nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause. A physical presence is not limited to an office or other physical building. Under Illinois law, it also includes the presence of any agent or representative of the seller. The representative need not be a sales representative. Subcontractors in Illinois are generally considered representatives of general contractors for purposes of determining physical presence for tax purposes.

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax on the purchase of the out-of-State goods and have a duty to self-assess their Use Tax liability and remit the amount directly to the State. The Use Tax rate is 6.25%.

CONSTRUCTION CONTRACTORS

Contractors that make improvements to real estate by taking materials off the market and permanently affixing them to real estate in Illinois owe Use Tax on the cost price of those materials. See the enclosed copies of 86 Ill. Adm. Code 130.1940 and 86 Ill. Adm. Code 130.2075. Those construction contractors do not incur Retailers' Occupation Tax liability when they permanently affix tangible personal property to real estate. If subcontractors are utilized and are acting as construction contractors, the transaction between the general contractors and the subcontractors is not a taxable transaction. The subcontractors incur Use Tax liability on any tangible personal property that they purchase for incorporation into real estate. If, however, general contractors make purchases and then contract to have subcontractors do the installation, the general contractors incur Use Tax liability because they are making the purchases of such tangible personal property.

It is important to note that since construction contractors are the end users of the materials that they permanently affix to real estate, their customers incur no Use Tax liability and the construction contractors have no legal authority to collect the Use Tax from their customers. However, many construction contractors pass on the amount of their Use Tax liabilities to customers in the form of higher prices or by including provisions in their contracts that require customers to "reimburse" the construction contractor for his or her tax liability. Please note that this reimbursement cannot be

billed to a customer as "sales tax," but can be listed on a bill as a reimbursement of tax. The choice of whether a construction contractor requires a tax reimbursement from the customer or merely raises his or her price is a business decision on the construction contractor's part.

Persons from other states who act as construction contractors in Illinois by permanently affixing tangible personal property to real estate owe Illinois Use Tax on the cost price of those materials. The Illinois Use Tax Act contains a credit provision for taxes which were properly due and paid to another state with respect to the purchase or use of tangible personal property in Illinois. See the enclosed copy of 86 Ill. Adm. Code 150.310(a)(3).

If an out-of-State contractor also makes retail ("over-the-counter") sales to Illinois customers without installation, that contractor may be required to register and collect Use Tax (6.25%) on those sales if the contractor has sufficient nexus under the Quill decision described above. Please note again that subcontractors in Illinois are generally considered representatives of general contractors for purposes of determining physical presence for tax purposes.

SHIPPING, INSTALLATION, OR TRAINING CHARGES

Whether shipping or freight charges may be deducted by retailers in calculating Retailers' Occupation Tax liability depends not upon the separate billing of such freight or delivery charges but upon whether the charges are included in the selling prices of the property or are contracted for separately by purchasers and retailers. See the enclosed copy of 86 Ill. Adm. Code 130.450. The best evidence that delivery charges were agreed to separately and apart from selling prices, are separate and distinct contracts for freight or shipping. Alternatively, documentation in the records of sellers that purchasers had options of taking delivery of the property at sellers' locations, for the agreed purchase prices, or having delivery made by sellers for the agreed purchase prices plus ascertainable delivery charges, may suffice.

Mail order delivery charges are deemed to be agreed upon separately from the selling price of the tangible personal property being sold so long as the mail order form requires a separate charge for delivery and so long as the charges designated as freight or delivery or shipping and handling are actually reflective of the costs of such shipping, transportation or delivery. To the extent that such charges exceed the actual costs of freight, shipping or delivery, the excess charges are subject to tax. See subsection (d) of Section 130.415.

In addition, where the seller engages in the business of selling tangible personal property at retail, and such tangible personal property is installed by the retailer, the receipts from such installation charges must be included in the gross receipts upon which his Retailers' Occupation Tax liability is measured if such installation charges are included in the selling price of the property being sold. See the enclosed copy of 86 Ill. Adm. Code 130.450. However, if the installation is to permanently affix the tangible personal property to real estate, the retailer is acting as a construction contractor and he incurs a Use Tax liability only on his cost price of materials (see above).

If, however, the seller and buyer agree upon the installation charges separately from the selling price of the tangible personal property which is sold, then the receipts from the installation charges are not a part of the "selling price" of the tangible personal property which is sold. Instead such charges constitute a service charge, separately contracted for, which need not be included in the figure upon which the seller computes his Retailers' Occupation Tax liability.

Likewise, if charges for training are included in the selling prices of the property being sold then those charges must be included in the gross receipts upon which the seller incurs Retailers' Occupation Tax liability. However, if charges for training are agreed upon by the buyer and seller separately from the selling price of the tangible personal property which is sold, then the receipts from the training charges are not a part of the gross receipts upon which the seller incurs Retailers' Occupation Tax liability.

RETURNS

To assist you in registering with the Department, we have enclosed a new business packet. All persons engaged in the business of selling tangible personal property at retail must register on Form NUC-1 and will be issued an Illinois Business Tax number (IBT number). These taxpayers file Form ST-1 on a monthly basis on or before the twentieth day of each month. See the enclosed copy 86 Ill. Adm. Code 130.501. A construction contractor's Use Tax liability is also reported on this form under the same IBT number.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

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If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Terry D. Charlton
Associate Counsel

TDC:msk
Enc.